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## REPORT OF THE ANNUAL MEETING

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April 20, 2007

WEST VIRGINIA ESSENTIAL PROPERTY INSURANCE ASSOCIATION

530 Walnut Street, Suite 1650  
Philadelphia, PA 19106-3698

Board of Directors  
2006-2007 Term

Mr. William Lingenfelter, Chairman .....	State Farm Insurance Companies
Mr. David A. McMillen, Vice Chairman. ....	Westfield Companies
Mr. Gary Auvil .....	Farmers Mutual Insurance Company
Mr. David V. Freeman .....	Erie Insurance Group
Mr. Thomas M. Giffen .....	Acordia of West Virginia
Ms. Michele Lilly .....	Nationwide Insurance
Mr. Jeffrey Williams, Esq. ....	Allstate Insurance Company
Mr. Daniel M. Taylor, Jr., Esq., General Counsel .....	Swartz Campbell, LLC
Mr. John M. Ogle, General Manager .....	West Virginia Essential Property Insurance Association

AGENDA  
ANNUAL MEETING  
OF THE  
WEST VIRGINIA ESSENTIAL PROPERTY INSURANCE ASSOCIATION  
APRIL 20, 2007  
8:30 A. M.  
EMBASSY SUITES - CHARLESTON, WEST VIRGINIA

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1. Call to Order - 8:30 A.M. - David A. McMillen, Acting Chairman, presiding
2. Approval of Minutes of Annual Meeting - April 25, 2006
3. Ratification of Board Action
4. Report of Chairman
5. Report of General Manager
6. Treasurer's Report
7. Appointment of Board of Directors 2007 - 2008  
(Appointment by Insurance Commissioner)
8. New Business
9. Adjournment

Minutes of the Annual Meeting  
of the Board of Directors  
of the West Virginia Essential Property Insurance Association  
April 20, 2007  
8:30 a.m.  
Embassy Suites Hotel  
Charleston, West Virginia

The West Virginia Essential Property Insurance Association Annual Meeting was held on April 20, 2007 at the Embassy Suites Hotel in Charleston, West Virginia. The Annual Meeting was called to order at 8:30 a.m. with Vice Chairman David McMillen presiding and Mr. John M. Ogle acting as secretary for the meeting.

Upon motion duly made, seconded and carried, the Minutes of the April 25, 2006 Annual Meeting were approved as distributed to member companies.

A motion to ratify the Board of Directors 2006-2007 term was duly made, seconded and carried.

Upon motion duly made, seconded and carried, the readings of the Chairman's Report, the General Manager's Report and the Treasurer's Report were waived as all three reports were included in the agenda packet and will be incorporated into the Annual Report distributed to member companies. Upon motion duly made, seconded and carried, the reports were accepted as presented.

By notice of the West Virginia Insurance Commissioner, the Honorable Jane L. Cline, the following individuals were appointed to the Board of Directors of the West Virginia Essential Property Insurance Association for the 2007 - 2008 term.

Mr. Gary R. Auvil  
Farmers Mutual Insurance Company

Mr. David V. Freeman  
Erie Insurance Group

Mr. Thomas M. Giffen  
Acordia

Mr. Glenn Hahn  
State Farm Insurance Companies

Ms. Michele Lilly  
Nationwide Insurance

Mr. David A. McMillen  
Westfield Companies

Mr. Jeffrey Williams  
Allstate Insurance Company

General Manager Ogle noted the 2006 Year End Financial Audit was provided to Board Members. The audit will be made part of the Annual Report distributed to member companies.

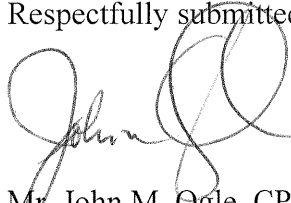
There being no further business and upon motion duly made, seconded and carried, the meeting was adjourned.

Approved by,



Mr. David A. McMillen  
Vice Chairman of the Board

Respectfully submitted by



Mr. John M. Ogle, CPCU  
General Manager

Report of the Chairman  
Mr. David A. McMillen

West Virginia Essential Property Insurance Association  
Annual Meeting of  
the Board of Directors  
April 20, 2007  
Charleston, West Virginia - Embassy Suites Hotel  
8:30 a.m.

Welcome to the 21<sup>st</sup> Annual Meeting of the West Virginia Essential Property Insurance Association. It is my pleasure to be here this morning and to report on the results of the past year.

In 2006, the West Virginia Essential Property Insurance Association earned \$852,072 in premium and incurred \$598,451 in losses. Loss Adjustment Expense Incurred totaled \$45,031 and Underwriting Expenses increased 12% to \$337,734, resulting in an Underwriting loss of \$129,144. Taking into account Investment Income and Other Income and Expenses, the 2006 final result was a loss of \$110,338.

Despite the financial loss, the West Virginia Essential Property Insurance Association continued to meet its obligations to the West Virginia member companies and to the citizens of West Virginia. The West Virginia Essential Property Insurance Association issued 1,481 policies during the year, 1,108 renewals and 373 new business policies and we paid out slightly more than \$704,000 in claim payments. In addition, the Association made substantial changes to its website to allow for the electronic completion and payment of new applications. The website also provides customers with many additional services such as the Underwriting Manual, copies of forms, electronic endorsement and inspection request and premium quotations while also providing member companies with needed financial reports.

As has been the case since we began operations, the West Virginia Essential Property Insurance Association's day to day operations are handled by the Management and staff of the Insurance Placement Facility of Pennsylvania. This cost sharing arrangement continues to be a positive situation for both organizations. I would like to thank General Manager John Ogle and his staff for their dedicated efforts to ensure that this arrangement works for the Association and the member companies, and most importantly for the citizens of West Virginia.

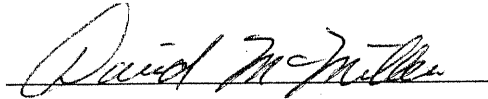
Report of the Chairman of the Board  
Mr. David A. McMillen  
West Virginia Essential Property Insurance Association  
Annual Meeting - April 20, 2007

I would like to note the retirement of my friend and long time West Virginia Essential Property Insurance Association Chairman of the Board, Mr. William Lingenfelter. Bill was such a regular participant at our meetings for so many years that it will seem strange for us to not have him in attendance. I would like to thank Bill for his efforts and wish him the very best in his new career.

As I take over the role of Chairman, I would also like to thank each of my fellow Board Members for their support and efforts over the past year. Your efforts in overseeing the operation are appreciated. I would also like to thank General Counsel, Dan Taylor for his service to the Association. Dan has provided the Association with good advice and counsel and his efforts should be duly noted. Lastly, I would like to thank all the members of the West Virginia Insurance Department and in particular, Commissioner Cline.

In closing, through the efforts of all, I can say without hesitation, that I look forward to serving as Chairman and meeting the challenges that lie ahead.

Respectfully submitted,

A handwritten signature in dark ink, appearing to read "David A. McMillen", is written over a horizontal line.

Mr. David A. McMillen  
Chairman of the Board

Report of the General Manager  
Mr. John M. Ogle

West Virginia Essential Property Insurance Association  
Annual Meeting  
April 20, 2007  
Embassy Suites Hotel  
Charleston, West Virginia

Good Morning. I'm pleased to be with you this morning and to have this opportunity to share with you the highlights and results of the past year. In 2006, the West Virginia Essential Property Insurance Association issued 1,481 policies, nearly a 10% decrease from the 1,643 policies issued in 2005. The decrease in Policies Issued established a two year depopulation trend after several years of sustained growth. For example, in 2001, we issued only 956 policies but for the next three years those numbers grew steadily to the 2004 peak of 1,687. In 2005 the numbers fell slightly to 1,643 and have continued to fall through 2006.

Last year, New Applications Received fell by 10% while Renewal Policies Issued decreased by 7% to 1,108 policies. The decrease in renewal business impacted Premiums Written, which fell 11.1% to \$794,840 and Premiums Earned, which declined 4.6% to \$852,072. The Average Policy Premium in 2006 fell by almost 1.5% to \$537.

On the claims side, in 2006 the Association recorded a 56.5% increase in the number of Losses Reported, from 23 to 36. The Association posted a Loss Incurred of \$598,451, an increase of 16.6%. The Average Paid Loss; however, declined just over 10% to \$27,079 per claim. The West Virginia Essential Property Insurance Association had no claim litigation activity during the year and unlike our early years of operation, the Association finished the year with no outstanding claims in litigation.

2006, like 2005, was best categorized as a year of uncertainty. Like all insurance companies, the West Virginia Essential Property Insurance Association was uncertain about the extension of the federal terrorism legislation and the eventual impact. The Association remained uncertain about the impact of state regulation changes and lastly, the Association was uncertain of the impact the catastrophes along the Gulf Coast might have on the West Virginia marketplace in general. More specific to our organization, the decline in new business and the uncertainties of future growth, made planning a difficult and inexact science.



The year 2006 was our 20<sup>th</sup> year of operation. Throughout the last two decades the Association has remained a small player in the West Virginia marketplace. As the insurance industry again adjusts itself to the changing conditions of the marketplace, the impact on the West Virginia Essential Property Insurance Association remains unknown. Regardless, the Association remains committed to operating a professional, efficient association in service to the property insurance industry as well as to the citizens of West Virginia.

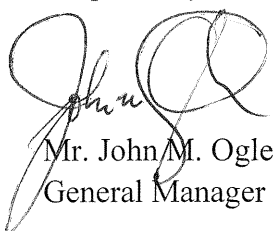
In 2006, the Association lost to retirement, our longtime Chairman of the Board, Mr. William Lingenfelter. Bill was on the Board for many years and served as our Chairman for nearly ten years. The Association will miss his leadership and his detailed knowledge of the marketplace. I would like to express my sincere thanks for his years of service and wish Bill well in his future endeavors.

I would also like to thank each member of the Board of Directors. As General Manager, I appreciate your continued interest and support. In these days of conflicting schedules, difficult airplane connections and time spent away from the office and friends, I know of your sacrifices and I appreciate your efforts.

I would be remiss if I did not thank the West Virginia Insurance Department and in particular, Commissioner Cline. Her input and guidance throughout the year has been most appreciated. Lastly, I would like to thank General Counsel Dan Taylor. Dan provided us with well thought out legal advice and counsel, all of which was appreciated.

The West Virginia Essential Property Insurance Association is fortunate to have the contribution of many talented individual employees, management and staff alike. Their dedication and commitment to the Association is commendable and it is because of their fine efforts we can look forward to the challenges of the future.

Respectfully,



Mr. John M. Ogle  
General Manager

# WEST VIRGINIA ESSENTIAL PROPERTY INSURANCE ASSOCIATION

## WEST VIRGINIA FAIR PLAN

### Treasurer's Report

December 31, 2006

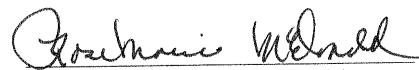
#### **ASSETS**

Cash in Bank	216,232.87
Investments, Short term at cost plus accumulated discount	219,861.16
Accrued Investment Income	0.00
Due from Participating Members	0.00
Premiums Receivable	13,140.39
Other Receivables	0.00
Prepaid Premium Tax	0.00
Equipment	0.00
Total Assets	<u>449,234.42</u>

#### **LIABILITIES AND MEMBERS' EQUITY**

Unearned Premiums	400,669.00
Unearned Advance Premiums	14,241.00
Outstanding Losses	103,900.00
Outstanding Loss Adjustment Expenses	9,732.00
Accrued Expenses	13,821.00
Unpaid Post Retirement Benefits	40,298.00
Unpaid Pension	25,207.00
Accounts Payable	1,761.68
Claims Checks Payable	63,089.10
Unpaid Premium Tax	11,893.71
Total Liabilities	<u>684,612.49</u>
Members' Equity (Deficit)	<u>(235,378.07)</u>
Total Liabilities and Members' Equity	<u>449,234.42</u>

Respectfully Submitted,



RoseMarie McDonald  
Accounting Manager



STATE OF WEST VIRGINIA


## Offices of the Insurance Commissioner

JOE MANCHIN III  
Governor

JANE L. CLINE  
Insurance Commissioner

### **M E M O R A N D U M**

TO: Gary R. Auvil – Farmers Mutual Insurance Company  
David V. Freeman – Erie Insurance Company  
Thomas M. Giffen – Acordia  
Glenn Hahn – State Farm Insurance Companies  
Michele Lilly – Nationwide Insurance  
David A. McMillen – Westfield Companies  
Jeffrey Williams – Allstate Insurance Company

FROM:   
Jane L. Cline  
Insurance Commissioner

DATE: April 2, 2007

RE: **Board of Directors – 2007-2008**  
**West Virginia Essential Property Insurance Association**  
**FAIR Plan**

I hereby appoint the above Board of Directors of the West Virginia Essential Property Insurance Association for 2007-2008.

I look forward to our efforts in maintaining an effective FAIR Plan.

JLC/jz

cc: John M. Ogle, CPCU  
General Manager



**WEST VIRGINIA ESSENTIAL PROPERTY  
INSURANCE ASSOCIATION**

Statutory Financial Statements,  
Independent Auditors' Report and  
Supplemental Schedules

For the years ended December 31, 2006 and 2005 .

**WEST VIRGINIA ESSENTIAL PROPERTY INSURANCE ASSOCIATION**

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**For the years ended December 31, 2006 and 2005**

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## Independent Auditors' Report

The Board of Directors  
West Virginia Essential Property Insurance Association

We have audited the accompanying statutory statements of admitted assets, liabilities, and members' deficit of West Virginia Essential Property Insurance Association (the "Association") as of December 31, 2006 and 2005, and the related statutory statements of operations and members' deficit and cash flows for the years then ended. These statutory financial statements are the responsibility of the Association's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As described more fully in Note 1 to the statutory financial statements, the Association prepared these statutory financial statements using accounting practices prescribed or permitted by the Insurance Department of the State of West Virginia, which is a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America.

The Association's liabilities exceeded its assets by \$235,379 and \$143,039 at December 31, 2006 and 2005, respectively. Such amounts, however, are recoverable from member companies (Note 2).

In our opinion, the statutory financial statements referred to above present fairly, in all material respects, the admitted assets, liabilities, and members' deficit of West Virginia Essential Property Insurance Association as of December 31, 2006 and 2005, and the results of its operations and its cash flows for the years then ended, on the basis of accounting described in Note 1.

Our audits were made for the purpose of forming an opinion on the statutory-basis financial statements taken as a whole. The accompanying supplemental investment disclosures, as of and for the year ended December 31, 2006, are presented to comply with the National Association of Insurance Commissioner's Accounting Practices and Procedures manual and is not a required part of the statutory-basis financial statements. Such information has been subjected to the auditing procedures applied in our audit of the statutory-basis financial statements and, in our opinion, is fairly stated in all material respects in relation to the statutory-basis financial statements taken as a whole.

This report is intended solely for the information and use of the Association and for filing with the Insurance Department of the State of West Virginia and other state insurance departments to whose jurisdiction the Association is subject and is not intended to be and should not be used by anyone other than these specified parties.

*Smart and Associates, LLP*

April 12, 2007

SMART and Associates, LLP

Certified Public Accountants

80 Lancaster Avenue | Devon, PA 19333 | 610.254.0700 | Fax 610.254.5293 | [www.smartgrp.com](http://www.smartgrp.com)

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**WEST VIRGINIA ESSENTIAL PROPERTY INSURANCE ASSOCIATION**  
Statutory Statements of Admitted Assets, Liabilities and Members' Deficit  
December 31, 2006 and 2005

	<u>2006</u>	<u>2005</u>
<b>ADMITTED ASSETS</b>		
Cash and cash equivalents	436,094	759,347
Premiums receivable	<u>13,140</u>	<u>14,190</u>
Total admitted assets	<u><u>\$ 449,234</u></u>	<u><u>\$ 773,537</u></u>
<b>LIABILITIES AND MEMBERS' DEFICIT</b>		
Liabilities:		
Unearned premiums	400,669	457,901
Due to related parties	63,089	82,135
Unpaid losses and loss adjustment expenses	113,632	249,949
Unearned advanced premiums	14,241	19,528
Postretirement benefits payable	40,298	37,029
Pension liability	25,207	41,775
Other liabilities	<u>27,477</u>	<u>28,259</u>
Total liabilities	684,613	916,576
Members' deficit	<u>(235,379)</u>	<u>(143,039)</u>
Total liabilities and members' deficit	<u><u>\$ 449,234</u></u>	<u><u>\$ 773,537</u></u>

*The accompanying notes are an integral part of these statutory financial statements.*

**WEST VIRGINIA ESSENTIAL PROPERTY INSURANCE ASSOCIATION**

Statutory Statements of Operations and Members' Deficit

For the years ended December 31, 2006 and 2005

	<u>2006</u>	<u>2005</u>
Underwriting:		
Premiums earned	<u>852,072</u>	<u>\$ 892,722</u>
Less:		
Losses incurred	598,451	513,396
Loss adjustment expenses incurred	45,031	65,840
Underwriting and other expenses incurred	<u>339,180</u>	<u>310,883</u>
	<u>982,662</u>	<u>890,119</u>
Net underwriting (loss) gain	<u>(130,590)</u>	<u>2,603</u>
Investment income	<u>18,554</u>	<u>2,395</u>
Other income (expense):		
Premiums receivable recovered (charged off)	724	(1,485)
Other (expense) income	<u>(473)</u>	<u>522</u>
Other income (expense), net	<u>251</u>	<u>(963)</u>
Net (loss) income	(111,785)	4,035
Members' deficit, beginning of year	(143,039)	(134,354)
Change in nonadmitted assets	(2,038)	2,478
Change in minimum pension liability	18,015	(15,198)
Refunds/assessments charged-off	<u>3,468</u>	<u>-</u>
Members' deficit, end of year	<u><u>\$ (235,379)</u></u>	<u><u>\$ (143,039)</u></u>

*The accompanying notes are an integral part of these statutory financial statements.*



**WEST VIRGINIA ESSENTIAL PROPERTY INSURANCE ASSOCIATION**

Statutory Statements of Cash Flows

For the years ended December 31, 2006 and 2005

	<u>2006</u>	<u>2005</u>
Cash flows from operating activities:		
Premiums collected, net	\$ 790,603	\$ 899,650
Loss and adjustment expenses paid (net of salvage and subrogation)	(779,799)	(694,956)
Underwriting expenses paid	(372,307)	(387,027)
Investment income	18,554	2,395
Premiums receivable recovered (charged off)	724	(1,485)
Other income	<u>(473)</u>	<u>522</u>
Net cash provided by operating activities	<u>(342,698)</u>	<u>(180,901)</u>
Cash flows from financing and other miscellaneous activities:		
Refunds/assessments charged-off	3,468	-
Other, net	<u>15,977</u>	<u>(10,192)</u>
Net cash provided (used) by financing and other miscellaneous activities	<u>19,445</u>	<u>(10,192)</u>
Net decrease in cash and cash equivalents	(323,253)	(191,093)
Cash and cash equivalents, beginning of year	<u>759,347</u>	<u>950,440</u>
Cash and cash equivalents, end of year	<u><u>\$ 436,094</u></u>	<u><u>\$ 759,347</u></u>

*The accompanying notes are an integral part of these statutory financial statements.*

## WEST VIRGINIA ESSENTIAL PROPERTY INSURANCE ASSOCIATION

Notes to Statutory Financial Statements  
For the years ended December 31, 2006 and 2005

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### 1. Summary of Significant Accounting Policies:

The statutory financial statements of West Virginia Essential Property Insurance Association (the "Association") have been prepared on the basis of accounting practices prescribed or permitted by the National Association of Insurance Commissioners ("NAIC") and the Insurance Department of the State of West Virginia.

The more significant accounting policies are as follows:

#### Premiums:

Premiums are recognized as revenues ratably over the terms of the policies. Unearned premiums are computed on the monthly pro rata basis.

#### Commissions:

Commissions and other costs of acquiring business are charged to operations as incurred.

#### Nonadmitted Assets:

Certain assets designated as "nonadmitted" are not reflected in the statutory statements of admitted assets, liabilities, and members' equity (deficit). Nonadmitted assets include furniture, fixtures, and leasehold improvements and are charged directly against members' equity (deficit).

#### Unpaid Losses and Loss Adjustment Expenses:

Unpaid losses and loss adjustment expenses are estimated based on losses reported and the Association's past experience for losses incurred but not yet reported. Management believes that such provisions are adequate to cover the ultimate liability. However, such estimates could differ from the amounts ultimately paid when claims are settled. Subsequent changes in estimates are reflected in earnings currently.

#### Use of Estimates:

The preparation of statutory financial statements in conformity with statutory accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the statutory financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

#### Cash and Cash Equivalents:

Cash and cash equivalents include cash on hand and other highly liquid temporary investments. The carrying value of cash equivalents approximates fair value. Interest and dividend income from cash and cash equivalents is included in investment income on the statutory statements of operations.

## WEST VIRGINIA ESSENTIAL PROPERTY INSURANCE ASSOCIATION

Notes to Statutory Financial Statements, continued

For the years ended December 31, 2006 and 2005

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### 1. Summary of Significant Accounting Policies, continued:

#### *Variances from Generally Accepted Accounting Principles:*

Certain of the prescribed or permitted insurance accounting practices followed by the Association differ from accounting principles generally accepted in the United States of America. The principal differences are as follows:

- Commissions and other acquisition costs, if recoverable from future operations, would be deferred and charged against operations on the same basis that related premiums are recognized as revenues.
- Certain assets designated as "nonadmitted" would be reflected in the statutory statement of admitted assets, liabilities, and members' deficit.
- Calculation of the pension obligation excludes non-vested employees.

The effects on the statutory financial statements of these differences have not been determined.

#### *Reclassifications:*

Certain prior year amounts have been reclassified to conform to the current year presentation.

### 2. General:

The Association was created by an act of the Legislature of the State of West Virginia to make available basic property insurance against fire and other perils for residential and business properties located in the state. All insurers doing any insurance business in West Virginia of the kinds covered by the Association are required to be a member. Each member participates in the profits and losses of the Association in the proportion that the net direct premiums of the member insurer for the second previous year bear to the net direct premiums written by all members for the second preceding calendar year and is subject to future cash assessments, if required. Members' deficit of \$235,379 and \$143,039 at December 31, 2006 and 2005, respectively will ultimately be assessed to the participating members as required.

The Association shares office space and the services of certain employees with the Insurance Placement Facility of Pennsylvania and the Insurance Placement Facility of Delaware and pays a portion of such joint expenses based on estimates of actual usage.

### 3. Federal Income Taxes:

The Association files as a partnership for federal income tax purposes. Consequently, the Association provides each member company with an annual statement of its relative share of the Association's annual results of operations for inclusion in each participating member's tax return.

# WEST VIRGINIA ESSENTIAL PROPERTY INSURANCE ASSOCIATION

Notes to Statutory Financial Statements, continued

For the years ended December 31, 2006 and 2005

## 4. Employee Benefits:

The Association, in conjunction with the Insurance Placement Facility of Pennsylvania and the Insurance Placement Facility of Delaware and other unaffiliated organizations, is a participant in the Prudential Retirement Insurance and Annuity Company Pension Plan, which covers all of its employees. The pension plan qualifies under the provisions of Section 501(a) of the Internal Revenue Code and is exempt from federal income taxes. The pension plan is funded through the trustee by contributions to group annuity contracts with two insurance companies.

The Association uses a December 31 measurement date for its pension plan. Assets, liabilities and expenses of the plan are allocated to the Association based on its underwriting activity. The allocation percentage used for the Association was 3.50% in 2006 and 3.28% in 2005.

The following table sets forth the year-end status of the plan:

	<u>2006</u>	<u>2005</u>
Change in projected benefit obligation:		
Benefit obligation at January 1	\$ 8,968,928	\$ 7,732,694
Service cost	197,895	202,812
Interest cost	493,638	465,463
Actuarial (gain) loss	(397,430)	794,494
Benefits paid	<u>(238,989)</u>	<u>(226,535)</u>
Benefit obligation at December 31	<u>9,024,042</u>	<u>8,968,928</u>
Change in plan assets:		
Fair value of plan assets at January 1	6,306,500	5,735,967
Actual return on plan assets	473,103	448,035
Employer contributions	510,119	349,033
Benefits paid	<u>(238,989)</u>	<u>(226,535)</u>
Fair value of plan assets at December 31	<u>7,050,733</u>	<u>6,306,500</u>
Funded status	(1,973,309)	(2,662,428)
Unrecognized net actuarial loss	<u>1,608,223</u>	<u>2,144,390</u>
	<u>\$ (365,086)</u>	<u>\$ (518,038)</u>

# WEST VIRGINIA ESSENTIAL PROPERTY INSURANCE ASSOCIATION

Notes to Statutory Financial Statements, continued

For the years ended December 31, 2006 and 2005

## 4. Employee Benefits, continued:

Weighted average assumptions used to determine benefit obligations at December 31:

	2006	2005
Discount rate	6.00%	5.50%
Rate of compensation increase	3.50%	3.25%

The net periodic pension cost for the plan includes the following components:

	2006	2005
Components of net periodic pension cost:		
Service cost	\$ 197,895	\$ 202,812
Interest cost	493,638	465,463
Expected return on plan assets	(503,639)	(492,289)
Amount of loss recognized	169,273	117,588
Net periodic pension cost	<u>\$ 357,167</u>	<u>\$ 293,574</u>

Weighted average assumptions used to determine the net periodic pension cost:

	2006	2005
Discount rate	6.00%	5.50%
Expected long-term rate of return	8.00%	8.50%
Weighted average rate of compensation increase	3.25%	3.25%

The accumulated benefit obligation for the plan was \$7,770,941 and \$7,694,367 at December 31, 2006 and 2005, respectively.

Accrued benefit cost was \$720,208 and \$1,387,867 at December 31, 2006 and 2005, respectively.

An additional minimum pension liability ("AML") is required when the actuarial present value of the accumulated plan benefit obligation exceeds plan assets and accrued pension liabilities. Pursuant to the requirements of SSAP No. 89, changes to the AML were recorded directly to members' deficit. The increase (decrease) in the AML during 2006 and 2005, respectively was (\$514,707) and \$560,358.

The benefit obligation excludes liabilities for nonvested employees, which were \$11,355 and \$6,899 at December 31, 2006 and 2005, respectively.

# WEST VIRGINIA ESSENTIAL PROPERTY INSURANCE ASSOCIATION

Notes to Statutory Financial Statements, continued

For the years ended December 31, 2006 and 2005

## 4. Employee Benefits, continued:

The expected long-term rate of return on assets assumption is 8.00%. As defined in Financial Accounting Standards ("FAS 87"), this assumption represents the rate of return on plan assets reflecting the average rate of earnings expected on the funds invested or to be invested to provide for the benefits included in the benefit obligation. The assumption has been determined by reflecting expectations regarding future rates of return for the investment portfolio, with consideration given to the distribution of investments by asset class and historical rates of return for each individual asset class.

The plan's weighted average asset allocations at December 31, 2006 and 2005, by asset category are as follows:

	<u>2006</u>	<u>2005</u>
Asset category:		
Equity securities	61.7%	59.6%
Debt securities	36.4%	39.7%
Cash	3.9%	0.7%

The primary investment objective for the pension plan assets is to achieve maximum rates of return commensurate with safety of principal, given the asset mix, credit quality and diversification guidelines and restrictions approved by the plan administrator's board of directors. The pension asset allocation is reviewed quarterly to determine whether the portfolio mix is within an acceptable range of target allocation. Target asset allocations are based on asset and liability studies with the goal to enhance the expected return of the pension portfolio while maintaining acceptable levels of risk. The target asset allocation is 60% equity securities and 40% debt securities.

Contributions to the plan are expected to be \$569,838 in 2007.

The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid:

2007	\$ 286,000
2008	332,000
2009	351,000
2010	377,000
2011	448,000
2012-2016	3,077,800

# WEST VIRGINIA ESSENTIAL PROPERTY INSURANCE ASSOCIATION

Notes to Statutory Financial Statements, continued

For the years ended December 31, 2006 and 2005

## 4. Employee Benefits, continued:

The Association provides life insurance for active employees upon the date of hire. The amount of insurance provided is equal to two times the employees' basic annual salary. For employees who are under age 65 at retirement, the Association continues to pay the full cost of life insurance until the employee reaches age 65, at which time coverage is reduced to \$5,000. For employees who retire at age 65 or older, the Association pays the full cost of life insurance with coverage limited to \$5,000.

Retired employees of the Association are provided Medicare HMO coverage. The HMO provides coverage for certain hospital, surgical, and medical costs not covered by Medicare. To be eligible for the HMO, a retiree must be 65 years of age or older and have at least five years of service with the Association.

The Association uses a December 31 measurement date for its postretirement benefit plan.

The following table sets forth the postretirement health care and life insurance benefit plan's funded status as of December 31, 2006 and 2005:

	<u>2006</u>	<u>2005</u>
Accumulated postretirement benefit obligation:		
Postretirement benefit obligation for retirees and fully vested plan participants	<u>\$ 446,038</u>	<u>\$ 470,580</u>
Accumulated postretirement benefit obligation in excess of plan assets	446,038	470,580
Unrecognized gain	538,968	560,987
Unrecognized prior service	<u>166,372</u>	<u>198,619</u>
Accrued postretirement benefit cost	<u>\$ 1,151,378</u>	<u>\$ 1,230,186</u>

The following table represents a reconciliation of postretirement benefit cost for the years ended December 31, 2006 and 2005:

	<u>2006</u>	<u>2005</u>
Accrued postretirement benefit cost at January 1	\$ 1,230,186	\$ 1,355,385
Benefit income for year	(47,650)	(47,381)
Benefits paid	<u>(31,158)</u>	<u>(77,818)</u>
Accrued postretirement benefit cost at December 31	<u>\$ 1,151,378</u>	<u>\$ 1,230,186</u>

# WEST VIRGINIA ESSENTIAL PROPERTY INSURANCE ASSOCIATION

Notes to Statutory Financial Statements, continued

For the years ended December 31, 2006 and 2005

## 4. Employee Benefits, continued:

Weighted average assumptions used to determine benefit obligations at December 31:

	<u>2006</u>	<u>2005</u>
Discount rate	6.00%	5.50%
Rate of compensation increase	3.50%	3.25%

Net periodic postretirement benefit cost for 2006 and 2005 includes the following components:

	<u>2006</u>	<u>2005</u>
Service cost	\$ -	\$ -
Interest cost	25,189	27,148
Amortization of gain	(32,247)	(32,247)
Amortization of prior service cost	(40,592)	(42,282)
Net periodic postretirement benefit cost	<u>\$ (47,650)</u>	<u>\$ (47,381)</u>

Weighted average assumptions used to determine the net periodic postretirement cost:

	<u>2006</u>	<u>2005</u>
Discount rate	5.50%	5.75%
Weighted average rate of compensation increase	3.25%	3.50%

For measurement purposes, for participants younger than age 65, healthcare cost trend increases of 10% and 11% were assumed for 2006 and 2005, respectively. These rate increases were assumed to decrease through 2011 and later when they level off at 5%. The healthcare cost trend rate assumption has an effect on the amounts reported. For example, increasing the assumed healthcare cost trend rate by one percentage point in each year would increase the accumulated postretirement benefit obligation as of December 31, 2006 by \$42,758 and net periodic postretirement benefit cost for the year ended December 31, 2006 by \$2,409.



# WEST VIRGINIA ESSENTIAL PROPERTY INSURANCE ASSOCIATION

Notes to Statutory Financial Statements, continued

For the years ended December 31, 2006 and 2005

## 4. Employee Benefits, continued:

The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid:

2007	\$ 32,735
2008	37,162
2009	39,526
2010	39,522
2011	42,375
2012-2016	273,916

The employees of the Association are eligible to participate in the Benefits Connection Group 401(k) Savings Plan, a defined contribution plan. The plan is administered by the Administration Committee for Benefits Connection Group Savings Plan. Participation in the plan is voluntary. Employees are vested in employer contributions upon participation. Employees may contribute 1% to 16% of their annual compensation on a before-tax basis and/or 1% to 16% of their annual compensation on an after-tax basis for a total of 16%. The Association matches employee contributions up to a maximum of 6% of an employee's annual compensation. Contributions by the Association amounted to \$4,002 and \$3,258 in 2006 and 2005, respectively.

## 5. Liability for Unpaid Losses and Loss Adjustment Expenses:

Activity in the liability for unpaid losses and loss adjustment expenses is summarized as follows:

	2006	2005
Balance, January 1	\$ 249,949	\$ 365,669
Incurred related to:		
Current year	621,288	639,371
Prior years	22,194	(60,135)
Total incurred	643,482	579,236
Paid related to:		
Current year	566,394	389,422
Prior years	213,405	305,534
Total paid	779,799	694,956
Balance, December 31	\$ 113,632	\$ 249,949

As a result of changes in estimates for anticipated losses and loss adjustment expenses related to insured events of prior years, the liability for losses and loss adjustment expenses increased (decreased) by \$22,194 and (\$60,135) in 2006 and 2005, respectively.

## 6. Lease Commitments:

# WEST VIRGINIA ESSENTIAL PROPERTY INSURANCE ASSOCIATION

Notes to Statutory Financial Statements, continued  
For the years ended December 31, 2006 and 2005

## 6. Lease Commitments:

The Association conducts its operations in leased premises under a lease that will expire April 30, 2008. At December 31, 2006, minimum rental commitments under this noncancelable lease are as follows:

### Year ending December 31:

2007	\$ 9,429
2008	3,143
Total payments	<u>\$ 12,572</u>

Total rental expense was \$10,601 and \$9,658 in 2006 and 2005, respectively.

The Association is charged a portion of the total rentals paid by Insurance Placement Facility of Pennsylvania for common facilities, based upon underwriting activity of the Association during the year. Rental commitment allocations are based upon continuation of the current level of activity.

## 7. Related Party Transactions:

The Insurance Placement Facility of Pennsylvania issues all checks, including those payable by the Association, and is then reimbursed by the Association (note 2). Throughout 2006 and 2005, \$1,018,288 and \$877,364, respectively, was paid by the Insurance Placement Facility of Pennsylvania on behalf of the Association. The related payable to the Insurance Placement Facility of Pennsylvania is \$63,089 and \$82,135 at December 31, 2006 and 2005, respectively.

## 8. Annual Statement Reconciliation:

The following is a reconciliation between the accompanying statutory financial statements and the Annual Statement for the years ended December 31, 2006 and 2005:

	2006	
	Net loss	Members' deficit
As reported in the Annual Statement	\$ (110,336)	\$ (235,379)
2006 underwriting and other expense adjustment	(1,449)	
As reported herein	<u>\$ (111,785)</u>	<u>\$ (235,379)</u>

**WEST VIRGINIA ESSENTIAL PROPERTY INSURANCE ASSOCIATION**  
Notes to Statutory Financial Statements, continued  
For the years ended December 31, 2006 and 2005

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8. Annual Statement Reconciliation, continued:

	<u>2005</u>	
	<u>Net income</u>	<u>Members' deficit</u>
As reported in the Annual Statement	\$ 13,434	\$ (143,039)
2005 underwriting and other expense adjustment	<u>(9,399)</u>	<u>-</u>
As reported herein	<u>\$ 4,035</u>	<u>\$ (143,039)</u>

The underwriting and other expense adjustments relate to the additional minimum pension liability adjustments discussed in note 4.

## **SUPPLEMENTAL SCHEDULES**

## WEST VIRGINIA ESSENTIAL PROPERTY INSURANCE ASSOCIATION

## Supplemental Investment Risk Interrogatories

December 31, 2006

Total admitted assets at December 31, 2006

\$ 449,234

1. State by investment category the 10 largest exposures to a single issuer/borrower/investment, excluding (i) U.S. government, U.S. government agency securities, and those U.S. government money market funds listed in the Appendix to the SVO Purposes and Procedures Manual as exempt; (ii) property occupied by the Company; and (iii) policy loans.

Investment category	Amount	Percentage of total admitted assets
None	\$ -	0.00%

2. State the amount and percentages of the reporting entity's total admitted assets held in bonds and preferred stocks by NAIC rating.

Bonds	Preferred stocks
None \$ -	None \$ -

3. The Company holds no foreign investments.
4. The Company holds no Canadian investments.
5. The Company holds no investments with contractual sales restrictions.
6. State the amounts and percentages of admitted assets held in the largest 10 equity interests (including investments in shares of mutual funds, preferred stocks, publicly traded equity securities, and other equity securities, and excluding money market and bond mutual funds listed in the Appendix to the SVO Practices and Procedures Manual as exempt or Class 1).

Investment category	Amount	Percentage of total admitted assets
None	\$ -	0.00%

7. The Company holds no nonaffiliated, privately placed equities.
8. The Company holds no general partnership interests.

**WEST VIRGINIA ESSENTIAL PROPERTY INSURANCE ASSOCIATION**

Supplemental Investment Risk Interrogatories, continued

December 31, 2006

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9. The Company holds no mortgage loans.
10. The Company holds no real estate.
11. The Company has no repurchase agreements.
12. The Company does not hold warrants.
13. The Company does not have exposure to collars, swaps, or forwards.
14. The Company does not have exposure for futures contracts.
15. The Company does not have amounts in the Write-Ins for Invested Assets category on the Summary Investment Schedule.

*See accompanying independent auditors' report.*

## WEST VIRGINIA ESSENTIAL PROPERTY INSURANCE ASSOCIATION

## Summary of Investments

December 31, 2006

<u>Investment categories</u>	<u>Gross investment holdings*</u>		<u>Admitted assets as reported in the annual statement</u>	
Cash and short-term investments	<u>\$ 436,094</u>	100%	<u>\$ 436,094</u>	100%
Total invested assets	<u><u>\$ 436,094</u></u>		<u><u>\$ 436,094</u></u>	

\*Gross investment holdings as valued in compliance with NAIC Accounting Practices and Procedures Manual.

*See accompanying independent auditors' report.*

## WEST VIRGINIA ESSENTIAL PROPERTY INSURANCE ASSOCIATION

## Reinsurance Interrogatories

December 31, 2006 and 2005

Provided below are management's responses to certain reinsurance interrogatories required by NAIC Statutory Accounting Principles:

Has the reporting entity reinsured any risk with any other entity under a quota share reinsurance contract that includes a provision that would limit the reinsurer's losses below the stated quota share percentage (e.g., a deductible, a loss ratio corridor, a loss cap, an aggregate limit or any similar provisions)? Yes ( ) No ( X )

Has the reporting entity ceded any risk under any reinsurance contract (or under multiple contracts with the same reinsurer or its affiliates) for which during the period covered by the statement: (i) it recorded a positive or negative underwriting result greater than 3% of prior year-end surplus as regards policyholders or it reported calendar year written premium ceded or year-end loss and loss expense reserves ceded greater than 3% of prior year-end surplus as regards policyholders; (ii) it accounted for that contract as reinsurance and not as a deposit; and (iii) the contract(s) contain one or more of the following features or other features that would have similar results:

- (a) A contract term longer than two years and the contract is noncancellable by the reporting entity during the contract term;
- (b) A limited or conditional cancellation provision under which cancellation triggers an obligation by the reporting entity, or an affiliate of the reporting entity, to enter into a new reinsurance contract with the reinsurer, or an affiliate of the reinsurer;
- (c) Aggregate stop loss reinsurance coverage;
- (d) An unconditional or unilateral right by either party to commute the reinsurance contract, except for such provisions which are only triggered by a decline in the credit status of the other party;
- (e) A provision permitting reporting of losses, or payment of losses, less frequently than on a quarterly basis (unless there is no activity during the period); or
- (f) Payment schedule, accumulating retentions from multiple years or any features inherently designed to delay timing of the reimbursement to the ceding entity.

Yes ( ) No ( X )

Has the reporting entity during the period covered by the statement ceded any risk under any reinsurance contract (or under multiple contracts with the same reinsurer or its affiliates), excluding cessions to approved pooling arrangements or to captive insurance companies that are directly or indirectly controlling, controlled by, or under common control with (i) one or more unaffiliated policyholders of the reporting entity, or (ii) an association of which one or more unaffiliated policyholders of the reporting entity is a member, where:

- (a) The written premium ceded to the reinsurer by the reporting entity or its affiliates represents fifty percent (50%) or more of the entire direct and assumed premium written by the reinsurer based on its most recently available financial statement; or
- (b) Twenty-five percent (25%) or more of the written premium ceded to the reinsurer has been retroceded back to the reporting entity or its affiliates.

Yes ( ) No ( X )

Except for transactions meeting the requirements of paragraph 30 of SSAP No. 62—Property and Casualty Reinsurance, disclose if the reporting entity ceded any risk under any reinsurance contract (or multiple contracts with the same reinsurer or its affiliates) during the period covered by the financial statement, and either:

- (a) Accounted for that contract as reinsurance (either prospective or retroactive) under statutory accounting principles ("SAP") and as a deposit under generally accepted accounting principles ("GAAP"); or
- (b) Accounted for that contract as reinsurance under GAAP and as a deposit under SAP?

Yes ( ) No ( X )